

STAFF REPORT, STAFF RECOMMENDATIONS, AND REQUEST FOR ADOPTION OF PROPOSED AMENDMENTS TO CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25137-8 AND THE ADOPTION OF PROPOSED CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25137-8.2, RELATING TO THE APPORTIONMENT OF THE INCOME OF MOTION PICTURE AND TELEVISION PRODUCERS, DISTRIBUTORS AND TELEVISION NETWORKS

Current Regulation section 25137-8 was originally adopted effective for income years beginning after January 1, 1982 and was renumbered to its current form in February 1987. The regulation was developed in conjunction with members of the motion picture and television industries.

Staff became aware that there were areas that the current regulation did not explicitly address and scheduled Interested Parties Meetings to discuss possible changes to the existing regulation. Interested Parties Meetings were held on January 8, 2008 and May 15, 2009. Summaries of those meetings were prepared and will be made part of the rulemaking file for these proposed actions.

As originally presented to the Franchise Tax Board on June 16, 2009, staff proposed to amend the current regulation. Members of the Franchise Tax Board expressed concerns that amendment of the current regulation might be construed as retroactively addressing issues that were interpreted differently by staff and some affected taxpayers.

To address that concern, staff modified the proposed action approved by the Board to (1) make no changes to the current regulation other than to renumber it as Regulation section 25137-8.1 and limit its effective date for taxable years beginning before January 1, 2010, and (2) propose the adoption of a new regulation reflecting the changes proposed to be made to the current regulation by staff and have the new regulation be effective with respect to taxable years beginning on or after January 1, 2010.

As required by the Administrative Procedures Act, a notice of hearing, scheduled for September 13, 2011, the proposed regulation language, and the initial statement of reasons supporting the proposed language of these two regulations was published in the Office of Administrative Law's register of proposed rulemaking actions and mailed to members of the public as provided for in Government Code section 11346.4 on July 29, 2011. In addition, the notice of proposed changes, the initial statement of reasons, and changes to proposed Regulation section 25137-8.2 proposed by staff were posted on the Franchise Tax Board's website, www.ftb.ca.gov.

The public hearing was held on September 13, 2011, with Benjamin F. Miller as the hearing officer. Staff proposed various non-substantive amendments to proposed Regulation section 25137-8.2. Comments were received from the public. Staff prepared a Summary of Comments and Response and Recommendations with respect to the comments received as a result of the hearing and distributed them to the attendees. A copy of this document is attached.

As a result of the hearing, staff posted a 15-day notice of changes to proposed Regulation section 25137-8.2 on October 27, 2011. No comments were received with respect to the proposed changes to proposed Regulation section 25137-8.2.

On November 11, 2011, staff received a comment from Jeff Vesely of Pillsbury, Winthrop Shaw Pittman LLP requesting that the operative date of amended Regulation section 25137-8.1 be extended to taxable years beginning before January 1, 2012, and that the proposed new Regulation section 25137-8.2 be operative for taxable years beginning on or after January 1, 2012. This comment was similar to a comment submitted in response to the original notice of hearing on the proposed amendment of Regulation section 25137-8 and the proposed adoption of Regulation section 25137-8.2. Staff discussed this proposed comment with industry and it has been determined that January 1, 2011 should be substituted for January 1, 2012. If the Board adopts this change, then staff will make available a 15-day notice of the change that will be published after today's Board meeting.

Copies of the proposed amendment to Regulation section 25137-8.1 and proposed Regulation section 25137-8.2 reflecting the changes made in response to the 15-day notice are attached and shown in ~~strikeout~~ and underscore.

Staff recommends that the Board adopt (1) the proposed amendment to Regulation section 25137-8 to renumber it as Regulation section 25137-8.1 and to extend the operative date of the regulation to taxable years beginning before January 1, 2011, and (2) proposed Regulation section 25137-8.2 and make it operative for taxable years beginning on or after January 1, 2011. Such action of the Board will be subject to the publication of a 15-day notice with respect to the operative dates of the regulations. If no comments are received in response to that notice, then staff will proceed with the submission of the two regulations for review and approval by the Office of Administrative Law.

TITLE 18. FRANCHISE TAX BOARD

As required by section 11346.4 of the Government Code, this is notice that a public hearing has been scheduled to be held at 1:00 p.m., September 13, 2011, at 9646 Butterfield Way, Town Center, Golden State Room A/B, Rancho Cordova, California, to consider the amendment of Section 25137-8 under Title 18 of the California Code of Regulations, and the adoption of Section 25137-8.2 under Title 18 of the California Code of Regulations, both of which relate to Motion Picture and Television Film Producers, Distributors, and Television Networks.

An employee of the Franchise Tax Board will conduct the hearing. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action if any person makes such request in writing.

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., September 13, 2011. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

AUTHORITY & REFERENCE

Section 19503 of the Revenue and Taxation Code authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of and to implement, interpret, and make specific Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001) and Part 11 (commencing with section 23001) of the Revenue and Taxation Code. Section 25137 of the Revenue and Taxation Code permits a departure from the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) when the standard provisions of UDITPA do not fairly reflect a taxpayer's activities in this state. The proposed regulatory action establishes appropriate rules for determining the apportionment factors for Motion Picture and Television Film Producers, Distributors, and Television Networks to fairly reflect their activities in this state.

INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

In 1982, the Franchise Tax Board adopted Regulation section 25137-8, relating to the apportionment of income for Motion Picture and Television Film Producers and Television Networks.

Subsequent to 1982, the industry has undergone significant changes. In the television industry, technology has changed and there are new types of programming transmitted via digital signal to satellites, accessed online or by affiliates and released to subscribers across the county. Similarly, in the motion picture industry, at the time the regulation was adopted in 1982, the focus was on major studios. While the regulation was subsequently amended to include independent television broadcasters, there was no inclusion of independent film distributors and they are not covered by the existing regulation. At one time, major studios controlled all stages of production and distribution. Now, many of these functions are commonly conducted by a separate entity, whether affiliated or independent. As a result of these changes, the existing regulation does not reflect the composition of the industry as it exists today.

The Multistate Tax Commission (MTC) provides model regulations, statutes and guidelines to promote uniformity in the states' taxation of interstate and foreign commerce. The MTC's model regulation for television and radio broadcasters, Regulation IV.18(h), was last amended in 1996. The proposed adoption of Regulation section 25137-8.2 includes amendments to align the California regulation with provisions contained in the MTC's model regulation. Other amendments are made to reflect the rules contained in Regulation section 25137-12, adopted in 1995, which addresses the print media industry. Finally, other changes from the current regulation have been made to incorporate changes suggested by interested parties.

To provide greater clarity to the existing rules, advertising revenue is now specifically identified as part of "film gross receipts" assigned by Regulation section 25137-8.2. This treatment is consistent with the practice of the Franchise Tax Board under current Regulation section 25137-8. In addition, Regulation section 25137-8.2 identifies "distributors" as part of the industry covered by this regulation, adds definitions, redefines "film" to include news or sports films produced for telecast, and identifies new technology used by the industry since the existing regulation was adopted.

The existing regulation is renumbered as Regulation section 25137-8.1 and its application is limited to taxable years beginning before January 1, 2010. For taxable years beginning on or after January 1, 2010, new Regulation section 25137-8.2 will apply.

DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

Mandate on local agencies and school districts: None.

Cost or savings to any state agency: None.

Cost to any local agency or school district which must be reimbursed under Part 7, commencing with Government Code section 17500, of Division 4: None.

Other non-discretionary cost or savings imposed upon local agencies: None.

Cost or savings in federal funding to the state: None.

Significant statewide adverse economic impact directly affecting business including the ability of California businesses to compete with businesses in other states: None.

Potential cost impact on private persons or businesses affected: The Franchise Tax Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

Significant effect on the creation or elimination of jobs in the state: None.

Significant effect on the creation of new businesses or elimination of existing businesses within the state: None.

Significant effect on the expansion of businesses currently doing business within the state: None. Motion picture and television film producers, and television networks, have been apportioning income pursuant to Regulation section 25137-8 since 1982. The proposed amendment of the existing regulation will have no effect on businesses currently doing business in California. Adoption of the proposed new regulation should not affect businesses currently doing business in California.

Effect on small business: None. The regulation is primarily utilized by large multi-state corporations and not small businesses.

Significant effect on housing costs: None.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Board must determine that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulatory action.

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of proposed Regulation section 25137-8.2 or would be as effective and less burdensome to corporate taxpayers.

The proposed regulatory action pertains to corporate taxpayers and therefore does not affect private persons.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulatory action is based. The statement includes the specific purpose of the proposed regulatory action and the factual basis for determining that the proposed regulatory action is necessary.

The express terms of the proposed text of the regulation, the initial statement of reasons and the rulemaking file are prepared and available upon request from the agency contact

person named in this notice. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board's website identified below.

CHANGE OR MODIFICATION OF ACTIONS

The proposed regulatory action may be adopted after consideration of any comments received during the comment period.

The regulation may also be adopted with modifications if the changes are nonsubstantive or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulation is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

ADDITIONAL COMMENTS

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter or sign language assistance should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

CONTACT

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at the Franchise Tax Board, Legal Branch, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-5306; FAX (916) 845-3648; E-Mail: Colleen.Berwick@ftb.ca.gov. In addition, all questions on the substance of the proposed regulation can be directed to Benjamin F. Miller: Telephone (916) 845-3320; FAX (916) 845-3648; E-Mail: Ben.Miller@ftb.ca.gov. The notice, initial statement of reasons and express terms of the regulation are also available at the Franchise Tax Board's website at www.ftb.ca.gov.

INITIAL STATEMENT OF REASONS FOR THE
AMENDMENT OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8, AND THE
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8.2

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE PROPOSED AMENDMENT TO REGULATION SECTION 25137-8 AND ADOPTION OF PROPOSED REGULATION SECTION 25137-8.2 ARE INTENDED TO ADDRESS

As originally presented to the Franchise Tax Board, staff proposed to amend the current regulation. Members of the Franchise Tax Board expressed concerns that amendment of the current regulation might be construed as retroactively addressing issues that were interpreted differently by staff and some members of the effected taxpayers. To address that concern staff has modified the proposed action to 1) make no changes to the current regulation other than to renumber it and limit its effective date and 2) propose the adoption of a new regulation reflecting the changes proposed to be made to the current regulation by staff and have the new regulation be effective with respect to future years.

The proposed amendments to the existing Regulation section 25137-8 renumber it as Regulation section 25137-8.1 and limit its taxable years of application.

Changes are made to current Regulation section 25137-8 in proposed Regulation section 25137-8.2 to add "Distributors" to those taxpayers subject to the regulation.

The adoption of proposed Regulation section 25137-8.2 is made to address the treatment of advertising revenue generated by film properties. Current regulation 25137-8 does not specifically address the treatment of receipts from advertising. The addition of language dealing with advertising, however, reflects the current interpretation and policy of the Franchise Tax Board with respect to such receipts. Furthermore, the treatment of advertising receipts and is consistent with Multistate Tax Commission Regulation IV.18(h) for television and radio broadcasters, with Regulation section 25137-12 for the print media industry and with similar rules adopted in at least one other state. The Franchise Tax Board's interpretation of the current regulation with respect to the treatment of advertising revenue is currently being challenged by several taxpayers. An amendment to the current regulation to reflect this policy is not being proposed so as not to preclude taxpayers contesting the Franchise Tax Board's policy from pursuing their remedies. No inference should be drawn from the fact that language addressing this issue is only included in proposed Regulation section 25137-8.2 and is not included in the proposed amendments to Regulation section 25137-8.1.

Changes are made to the current regulation which excluded news and sports filmed for telecast from the definition of films to now included them in the definition of films. This means news and sports filmed for telecast will now be included in the calculation of the

property factor as films. This change conforms California's treatment to the provision of the Multistate Tax Commission Regulation IV.18(h).

The current regulation, which will hereinafter be Regulation section 25137-8.1, is applicable to producers of commercials. Producers of commercials were removed from proposed Regulation 25137-8.2 so that the proposed regulation would conform to Regulation IV.18.(h) of the Multistate Tax Commission. Whether this elimination should be made is a question to be discussed at the hearing on the proposed amendment to the current regulation and adoption of the new regulation.

The proposed regulation 25137-8.2 modifies the current regulation by adding a sentence stating the ownership of movie theatres does not make an entity a distributor. The intent of this insertion was to make it clear that ownership of movie theatres by itself did not make an entity a distributor. At issue that may be discussed at the hearing is whether this sentence needs to be changed to make clear that a film distributor who also owns movie theatres is still a distributor for purposes of the proposed regulation.

An issue to be discussed at the hearing is whether language should be added to proposed Regulation Section 25137-8.2 to provide for the inclusion of other means of distribution of film properties.

Staff also proposes to make non-substantive changes to the proposed Regulation section 25137-8.2 as noticed to 1) reorder the definitions to place them in alphabetical order; 2) to include the various definitional provisions relating to "films" in a single paragraph and subparagraphs; 3) to re-write paragraph (c)(1)(A) to clearly differentiated the rental of studio property and equipment from short term rentals of similar equipment; and 4) to insert a general paragraph in (c)(3) so that it will contain both a subsection (A) and (B). These changes will be discussed at the hearing and staff's draft language will be made available.

SPECIFIC PURPOSE OF THE REGULATIONS

The proposed amendments to the existing regulation are necessary to limit its application to specified taxable years.

The adoption of the new regulation specifically identifies "distributors" as a part of the industry covered by this regulation. In addition, the proposed new regulation provides clarity as to the assignment of advertising revenue generated in conjunction with films in release, an issue not specifically listed in current Regulation section 25137-8.

NECESSITY

The existing regulation, which was adopted in 1982, no longer reflects the industry as it exists today. Because of changes in which the industry is organized and operates there is a need to update the rules to reflect these changes. In addition the existing regulation is not consistent with rules adopted in other states for the same industry, with Regulation section 25137-12 for the print media industry, nor with the Multistate Tax Commission Regulation IV.18(h) for television and radio broadcasters. Because there is a lack of consistency in

these rules for the assignment of income members of the industry may be subject to duplicative tax burdens or they may be able to avoid state taxes. Having a uniform set of rules adopted by a number of states addresses this problem.

The proposed amendment to renumber the existing regulation is necessary because changes which are not specifically provided for in the current regulation, but which reflect current department practice accepted by most members of the industry, that would be accomplished by amendment might be viewed as substantive. By amending the current regulation by re-denominating it and limiting the years for which its effective the respective positions of the department and taxpayers will not be effected.

Adopting a new regulation is proposed because changes are being made to the existing regulation to reflect current department practice, but which might be viewed as substantive. The changes are made by adopting a new regulation so as not to raise inferences about changes arising from amending the existing regulation.

The industry covered by the proposed regulation has changed in that the number of independent distribution companies has increased and there is a greater separation of production and distribution. Because the assignment of the income of independent distribution companies presents problems similar to those involved with producers and companies which both produced and distributed films and similar properties the same rules should apply to independent distributors. Including distributors in the class covered by the regulation accomplishes this purpose.

The changes are being proposed in the new regulation because they will make California's regulation consistent with a similar regulation adopted by the Multistate Tax Commission, Multistate Tax Commission Regulation IV.18(h), and adopted by other states. The Multistate Tax Commission is the administrator body of the Multistate Tax Compact of which California is a member. One of the goals of the compact is to promote uniformity in state tax practices with respect to the division of the corporate income tax base so there will be neither duplicative taxation nor under taxation of corporate income. Because California's rules are similar or identical to the rules of other states these goals are achieved.

These changes are being proposed because California adopted a regulation, 25137-12 for the print media which was adopted subsequent to the current regulation 25137-8 and which provides rules for the assignment of revenue from advertising. The proposed regulation contains rules for the assignment of sales from advertising because it is similar to the advertising revenue received by the print media and the similar type of revenue should be assigned in the same basic manner.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The Franchise Tax Board examined and considered the history of Regulation section 25137-8, including public hearing documents, Regulation section 25137-12, and the Multistate Tax Commission's Regulation IV.18(h) . The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption of these amendments to Regulation section 25137-8 of the California Code of Regulations.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS

The Franchise Tax Board has determined that there are no alternatives which would be more effective in carrying out the purpose of the proposed amendments to Regulation section 25137-8, and the adoption of Regulation section 25137-8.2, or would be as effective and less burdensome to affected private persons or small business than the proposed amendments. In addition, the proposed amendments pertain to corporate taxpayers and therefore do not affect private individuals.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that the proposed amendments to Regulation section 25137-8 and the adoption of Regulation section 25137-8.2 of the California Code of Regulations will not have a significant overall economic impact on business.

SUMMARY OF COMMENTS RECEIVED, RESPONSES AND RECOMMENDATIONS
FOR PROPOSED AMENDMENT OF REGULATION SECTION 25137-8

Proposed Amendment of (a):

COMMENT: The current regulation should be effective for income years beginning on or after January 1, 1982, and before January 1, 2012. Revenue and Taxation Code Section 19503(b)(1) provides that

Except as otherwise provided in this subdivision, no regulation relating to . . . Part 11 (commencing with Section 23301), or this part shall apply to any taxable year ending before the date on which any notice substantially describing the expected contents of any regulation is issued to the public.

None of the exceptions to subdivision (b)(1) in Revenue and Taxation Code section 19503, subdivision (b)(2), are relevant.

Furthermore, the Initial Statement of Reasons, in accordance with directions of the three-member Board, provides that the amendments are to be effective for future years. The Initial Statement of Reasons was issued in August of 2011. [Jeffrey M. Vesely, Pillsbury Winthrop Shaw Pittman Transcript of Hearing Sept. 13, 2011 pg 10-11; Pillsbury Winthrop Shaw Pittman LLP, Written Comment Sept 22, 2011]

RESPONSE: Revenue and Taxation Code section 19503, subdivision (c), provides that:

The amendments made by the act adding this subdivision are operative with respect to regulations which relate to California statutory provisions enacted on or after January 1, 1998.

The amendments referred to in subdivision (c) are the addition of subdivision (b) to Section 19503 and amendments to subdivision (a).

The proposed amendment relates to Section 25137 of the Revenue and Taxation Code, which was adopted in 1966 and became operative January 1, 1967. Subdivision (b) of Revenue and Taxation Code section 19503 is not applicable.

Revenue and Taxation Code section 19503, as it existed prior to the amendments that included subdivisions (b) and (c), provided in relevant part:

The Franchise Tax Board . . . may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect.

The Franchise Tax Board is not required by law to have the amendments to this regulation apply prospectively. Under the controlling statute the amendments apply retroactively to all years unless the Franchise Tax Board determines otherwise.

The proposed amendments to the regulation were discussed with the affected industry at interested parties meetings beginning in January of 2008 and May of 2009. The proposed amendments to the regulation were presented to the Franchise Tax Board at its meeting of June 16, 2009. At the meeting the Board gave permission for the staff to proceed to hold hearings on the proposed amendments. The effective date of the proposed amendments to the regulation are consistent with the date proposed in the presentation made to the Board at its June 16, 2009 meeting. The industry was put on notice as to the effective date at that time.

RECOMMENDATION: Because the industry has been on notice as to the proposed amendments at least as early as the June 16, 2009 Board meeting, and because the Board approved noticing the proposed amendments with the effective date provided for in the proposed amendments, staff recommends that no change be made in the effective date.

SUMMARY OF COMMENTS RECEIVED, RESPONSES AND RECOMMENDATIONS
FOR PROPOSED ADOPTION OF REGULATION SECTION 25137-8.2

Subsection (a)

COMMENT: The regulation should be applicable to producers and distributors of television commercials whose business and products are similar to those of motion picture and television producers and distributors. [Franchise Tax Board Staff]

RESPONSE: Current regulation 25137-8 is applicable to the producers of television commercials. Model regulation IV.18.(h) adopted by the Multistate Tax Commission is not applicable to producers of television commercials. One of the justifications for adopting proposed Regulation section 25137-8.2 is to conform California's regulation and treatment of the industry to that adopted by the Multistate Tax Commission to promote uniformity with those states that have adopted the Multistate Tax Commission's model regulation.

The application of the current regulation to the producers of television commercials has not produced any controversies. Staff made the suggested change to the proposed regulation available to the public at the hearing and solicited comments with respect to the possible change. No comments were received. The extension of the proposed regulation to producers and distributors of television commercials is unlikely to create significant issues of non-uniformity.

RECOMMENDATION: The extension of the proposed regulation to producers and distributors of television commercials should be adopted.

Subsection (b)

COMMENT: The definitions could be arranged in alphabetical order and the definitions applicable to "films" should be placed in a single subsection. [Franchise Tax Board Staff]

RESPONSE: The suggested changes are only organizational and have no substantive effect. Staff's proposal was made available at the hearing and no objections were raised

RECOMMENDATION: Revised subsection (b) as suggested by staff.

Subsection (b)(3)

COMMENT: Clarification should be provided that the owning of movie theaters in which films are exhibited does not by itself constitute the act of distribution. [Franchise Tax Board staff]

RESPONSE: Efforts should be made to eliminate possible ambiguities. The public was put on notice of this possible change and no objections were received.

RECOMMENDATION: The proposed regulation should be changed. No substantive change will result.

Subsection (c)

COMMENT: The motion picture and television industry is undergoing changes in the methods of distribution. In order for the proposed regulation to anticipate these changes a sentence needs to be added which provides for the continuing application of the principles of the proposed regulation to these new technologies.

RESPONSE: Staff prepared language to be added to the proposed regulation that reflects its continuing application to new technologies. This language was made available to the public and comments were solicited. No comments were received.

RECOMMENDATION: The language of the proposed regulation should be amended to address this situation.

Subsection (c)(1)(A)(i)

COMMENT: There is a possible ambiguity in the proposed regulation as to the treatment of property that is rented for short periods of time and is not supplied by a studio. The proposed language should be amended by breaking the language into two separate sentences. [Franchise Tax Board staff]

RESPONSE: Staff made the proposed changes available to the public and requested comments. No comments regarding the proposed change were received.

RECOMMENDATION: The proposed change should be made.

Subsection (c)(3)(A)

COMMENT: There is no subsection (c)(3)(B). The current language addresses the assignment of advertising revenue to the numerator of the sales factor. Adding language describing the denominator of the sales factor, even to a limited extent, would allow the current language to be redenominated as subsection (c)(3)(B). [Franchise Tax Board staff]

RESPONSE: While no substantive change is intended, this was not a matter discussed at Interested Party Meetings. Inserting language at this point may create uncertainties that have not existed.

RECOMMENDATION: No change should be made.

Subsection (d)

COMMENT: The current regulation should be effective for income years beginning on or after January 1, 2012. Revenue and Taxation Code section 19503, subdivision (b)(1), provides that:

Except as otherwise provided in this subdivision, no regulation relating to . . . Part 11 (commencing with Section 23301), or this part shall apply to any taxable year ending before the date on which any notice substantially describing the expected contents of any regulation is issued to the public.

None of the exceptions to subdivision (b)(1) in Revenue and Taxation Code Section 19503, subdivision (b)(2), are relevant.

Furthermore, the Initial Statement of Reasons, in accordance with direction from the three-member Board, provides that the adoption is to be effective for future years. The Initial Statement of Reasons was issued in August of 2011. [Jeffrey M. Vesely, Pillsbury Winthrop Shaw Pittman Transcript of Hearing Sept. 13, 2011 pg 10-11; Pillsbury Winthrop Shaw Pittman LLP, Written Comment Sept 22, 2011]

RESPONSE: Revenue and Taxation Code section 19503, subdivision (c), provides that:

The amendments made by the act adding this subdivision are operative with respect to regulations which relate to California statutory provisions enacted on or after January 1, 1998.

The amendments referred to in subdivision (c) are the addition of subdivision (b) to Section 19503 and amendments to subdivision (a).

The proposed regulation relates to Section 25137 of the Revenue and Taxation Code, which was adopted in 1966 and became operative January 1, 1967. Subdivision (b) of Revenue and Taxation Code section 19503 is not applicable.

Revenue and Taxation Code section 19503, as it existed prior to the amendments that included subdivisions (b) and (c), provided in relevant part:

The Franchise Tax Board . . . may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect.

The Franchise Tax Board is not required by law to have the proposed regulation apply prospectively. Under the controlling statute the proposed regulation applies retroactively to all years unless the Franchise Tax Board determines otherwise.

The proposed regulation was discussed with the affected industry at interested parties meetings beginning in January of 2008 and May of 2009. The proposed regulation was presented to the Franchise Tax Board at its meeting of June 16, 2009. At the meeting the Board gave permission for the staff to proceed to hold hearings on the proposed regulation. The effective date of the proposed regulation is consistent with the date proposed in the presentation made to the Board at its June 16, 2009 meeting. The industry was put on notice as to the effective date at that time.

RECOMMENDATION: Because the industry has been on notice as to the proposed amendments at least as early as the June 16, 2009 Board meeting, and because the Board

approved noticing the proposed regulation with the effective date provided for in the proposal, staff recommends that no change be made in the effective date.

Statement of Reasons

COMMENT: The Initial Statement of Reasons states:

Changes are made to the current regulation which excluded news and sports filmed for telecast from the definition of films to now included [sic] them in the definition of films. This means news and sports filmed for telecast will now be included in the calculation of the property factor as films. This change conforms California's treatment to the provision of the Multistate Tax Commission Regulation IV.18(h)

We would suggest that the following sentence should be inserted between the second and third sentences to make it clear that this change also affects the calculation of the sales factor:

In addition, revenues from news and sports will now be included in the calculation of the sales factor under paragraph (c)(3)(A).

[Jeffrey M. Vesely, Pillsbury Winthrop Shaw Pittman Transcript of Hearing Sept. 13, 2011 pg 11; Pillsbury Winthrop Shaw Pittman LLP, Written Comment Sept 22, 2011]

RESPONSE: The comment is directed to the Initial Statement of Reasons and is not directed to the proposed regulation. The term "film" is included within the definitions in subsection (b). The term "film" is used in both the property factor, subsection (d)(2), and the sales factor, subsection (d)(4) without any qualification. Therefore "film" has the same meaning for both the property factor and the sales factor.

Staff does not believe there is a lack of clarity in the Initial Statement of Reasons so there will be no effect with respect to the proposed regulation in making, or not making, this addition.

RECOMMENDATION: Staff recommends that the requested sentence be included in the Final Statement of Reasons.

Notice of Modifications to Text of
Proposed Regulation Section 25137-8.2, Relating to the Apportionment of the
Income of Motion Picture and Television Film Producers, Distributors, and
Television Networks

A hearing was on September 13, 2011, by Benjamin F. Miller, Retired Annuitant of the Franchise Tax Board Legal Division, the "hearing officer," on a proposed amendment to California Code of Regulations, title 18, to adopt section 25137-8.2 (Regulation section 25137.8-2) which was noticed in the California Regulatory Notice Register on July 29, 2011.

Department staff reviewed the proposed regulation language and considered the comments submitted at and before the hearing. The hearing officer recommends that the proposed new regulation section be amended as described in more detail below. The proposed changes to the proposed regulation were available prior to the hearing of September 13, 2011 on the Franchise Tax Board's website and were provided to the public at the hearing on September 13, 2011. Comments were requested and none were received relating to these changes.

These nonsubstantial or sufficiently related changes (within the meaning of Govt. Code Section 11346.8) recommended by the hearing officer are reflected in the attachment hereto. These amendments to the regulation are reflected by underscore for additions and strikeout for deletions. Proposed changes to Regulation section 25137-8.2 are summarized below.

1. Subsection (a) is amended to apply the proposed regulation to the producers and distributors of television commercials. Current regulation section 25137-8 is applicable to the producers of television commercials. These entities were eliminated from the proposed regulation to conform the regulation to Regulation IV.18.(h) of the Multistate Tax Commission. Staff requested comments on whether there was objection to including the producers and distributors of television commercials in the proposed regulation and no objections were voiced. This change conforms the proposed regulation to the current regulation.
2. Subsection (b) has been reordered to place the definitions in alphabetical order and to consolidate the definition of "films" into a single subsection. There is no change in the wording of the definitions.
3. Subsection (c) has been amended to include a sentence providing that new technologies will be handled in a manner consistent with the proposed regulation.
4. Subsection (c)(1)(A) has been amended by dividing what was one sentence into two sentences to provide more clarity. No change in the intended meaning results.

These sufficiently related changes are being made available to the public for the 15 day period required by Government Code section 11346.8, subdivision (c), and California Code of Regulations, title 1, section 44. Written comments regarding these changes will be accepted until 5:00 pm on November 14, 2011. The Franchise Tax Board is sending a copy of the proposed amendments to proposed Regulation section 25137-8.2 to all individuals

who requested notification of such changes, as well as those who commented in writing to the previously noticed proposed adoption of Regulation section 25137-8.2

All inquiries and written comments concerning this notice should be directed to Colleen Berwick at (916) 845-3306, FAX (916) 845-3648, E-Mail Colleen.Berwick@ftb.ca.gov; or by mail to the Legal Division, Attn: Colleen Berwick, P.O. Box 1720, Rancho Cordova, CA 95741-1720. The notice and the proposed amendments will also be made available at the Franchise Tax Board's website at <http://www.ftb.ca.gov/>.

SUMMARY OF COMMENTS RECEIVED IN RESPONSE TO THE 15-DAY NOTICE OF
OCTOBER 27, 2011 - NON-SUBSTANTIVE CHANGES, RESPONSES AND RECOMMENDATIONS
TO THE PROPOSED AMENDMENT OF REGULATION 25137-8.1

Proposed Amendment of (a)

COMMENT: The current regulation should be effective for income years beginning on or after January 1, 1982, and before January 1, 2012.

The Legislative History of the amendments to Revenue and Taxation Code Section 19503 establish that it was intended to conform to Internal Revenue Code Section 7805 which provides relief from retroactive application of regulations. The proposed regulation is a special industry regulation which is more akin to a legislative regulation and should therefore be applied prospectively. Proposed Regulation Section 25137-8.2 makes significant changes in existing law. Finally, the three-member Franchise Tax Board directed staff that the proposed changes should be effective for future years.[Pillsbury Winthrop Shaw Pittman LLP, Written Comment Nov 11, 2011]

RESPONSE: Revenue and Taxation Code Section 19503(c) provides that

The amendments made by the act adding this subdivision are operative with respect to regulations which relate to California statutory provisions enacted on or after January 1, 1998.

The amendments referred in subsection (c) are the addition of subsection (b) to Section 19503 and amendments to subsection (a).

The proposed amendment relates to Section 25137 of the Revenue and Taxation Code which was adopted in 1966 effective January 1, 1967. Subsection (b) of 19503 is not applicable.

Revenue and Taxation Code Section 19503 as it existed prior to the amendments that included subsections (b) and (c) provided in relevant part

The Franchise Tax Board . . . may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect.

The Franchise Tax Board is not required by law to have the amendments to this regulation apply prospectively. Under the controlling statute the amendments apply retroactively to all years unless the Franchise Tax Board determines otherwise.

The proposed amendments to the regulation were discussed with the affected industry at interested party meetings beginning in January of 2008 and May of 2009. The proposed amendments to the regulation were presented to the Franchise Tax Board at its meeting of June 16, 2009. At the meeting the Board gave permission for the staff to proceed to hold hearings on the proposed amendments. The effective date of the proposed amendments to

the regulation are consistent with the date proposed in the presentation made to the Board at its June 16, 2009 meeting. The industry was put on notice as to the effective date at that time.

Despite the above analysis, staff has had further dialogue with industry and has reached a determination that the regulation should be amended to make 25137-8.1 effective for all years beginning on or after January 1, 1982 and before January 1, 2011. While this is not the January 1, 2012 date that was requested by the commentator, it is staff's understanding that the January 1, 2011 date is sufficient to alleviate the concerns of the commentator.

RECOMMENDATION: Based upon discussions with interested parties it was agreed that the current regulation should be applied to taxable years beginning before January 1, 2011.

SUMMARY OF COMMENTS RECEIVED IN RESPONSE TO THE 15-DAY NOTICE OF NON-SUBSTANTIVE CHANGES, AND RESPONSES AND RECOMMENDATIONS TO THE PROPOSED ADOPTION OF REGULATION SECTION 25137-8.2

Subsection (d)

COMMENT: The current regulation should be effective for taxable years beginning on or after January 1, 1982, and before January 1, 2012.

The Legislative History of the amendments to Revenue and Taxation Code section 19503 establish that it was intended to conform to Internal Revenue Code section 7805 which provides relief from retroactive application of regulations. The proposed regulation is a special industry regulation which is more akin to a legislative regulation and should therefore be applied prospectively. Proposed Regulation section 25137-8.2 makes significant changes in existing law. Finally, the three-member Franchise Tax Board directed staff that the proposed changes should be effective for future years. [Pillsbury Winthrop Shaw Pittman LLP, Written Comment, November 11, 2011.]

RESPONSE: Revenue and Taxation Code section 19503, subdivision (c), provides that:

The amendments made by the act adding this subdivision are operative with respect to regulations which relate to California statutory provisions enacted on or after January 1, 1998.

The amendments referred in subdivision (c) are the addition of subdivision (b) to section 19503 and amendments to subdivision (a).

The proposed amendment relates to section 25137 of the Revenue and Taxation Code, which was adopted in 1966, operative January 1, 1967. Subdivision (b) of 19503 is thus not applicable.

Revenue and Taxation Code section 19503, as it existed prior to the amendments that included subdivisions (b) and (c), provided in relevant part:

The Franchise Tax Board . . . may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect.

The Franchise Tax Board is not required by law to have the amendments to this regulation apply prospectively. Under the controlling statute the amendments apply retroactively to all years unless the Franchise Tax Board determines otherwise.

The proposed amendments to the regulation were discussed with the affected industry at interested parties meetings beginning in January of 2008 and ending in May of 2009. The proposed amendments to the regulation were presented to the Franchise Tax Board at its meeting of June 16, 2009. At the meeting the Board gave permission for the staff to proceed to hold hearings on the proposed amendments. The effective date of the proposed

amendments to the regulation is consistent with the date proposed in the presentation made to the Board at its June 16, 2009 meeting. The industry was put on notice as to the effective date at that time.

Despite the above analysis, staff has had further dialogue with industry and has reached a determination that the regulation should be amended to include an operative date of January 1, 2011. While this is not the January 1, 2012 date that was requested by the commentator, it is staff's understanding that the January 1, 2011 date is sufficient to alleviate the concerns of the commentator.

RECOMMENDATION: The current regulation (section 25137-8.2) should be amended to be applied to taxable years beginning after January 1, 2011.



Pillsbury Winthrop Shaw Pittman LLP

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Jeffrey M. Vesely

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May 22, 2009

VIA FACSIMILE

Colleen Berwick
Franchise Tax Board
P.O. Box 1720
Sacramento, CA 95741-1720

Re: Regulation 25137-8

Dear Ms. Berwick:

This letter is presented on behalf of Pillsbury Winthrop Shaw Pittman LLP. In the Interested Parties Meeting held on May 15, 2009 in connection with Regulation 25137-8, we presented oral comments regarding the Explanation of Proposed Draft of Regulation Section 25137-8 ("Explanation"). We indicated that we would provide those comments and suggested revisions to the Explanation in writing.

1. Explanation No. 9. This paragraph should be revised to specifically note that certain taxpayers do not share staff's belief that the inclusion of advertising revenue as a gross receipt is not a substantive change to the existing regulation. Given that the proposed changes to the regulation are prospective in nature, we submit that the language should be made clear in this regard. We would suggest substituting the following for the second and third sentences of that paragraph:

"While there are substantive changes from the existing regulation (specifically identifying distributors as a part of the industry covered by this regulation, redefining 'film,' and identifying new technology used by the industry since the prior regulation was adopted), staff does not believe that inclusion of advertising revenue as a gross receipt is a substantive change to the existing regulation. Certain taxpayers do not agree with staff and assert that the inclusion of advertising revenue as a gross receipt is a substantive change to the existing regulation."

Colleen Berwick
May 22, 2009
Page 2

2. Explanation No. 5. Similar to our comments regarding Explanation No. 9 above, this paragraph should be revised to make it clear that the addition of the words "gross receipts from advertising revenue" is viewed by certain taxpayers as a substantive change to the existing regulation. We would suggest substituting the following for the last sentence of that paragraph:

"It is staff's belief that this language makes no substantive change to the existing regulation. Certain taxpayers do not agree with staff and assert that the inclusion of advertising revenue as a gross receipt is a substantive change to the existing regulation."

3. Explanation No. 6. Again, similar to our comments regarding Explanation Nos. 5 and 9 above, this paragraph should be revised to make it clear that the specific inclusion of advertising revenue in gross receipts is viewed by certain taxpayers as a substantive change to the existing regulation. We would support substituting the following for the last sentence of that paragraph:

"It is staff's belief that this language makes no substantive change to the existing regulation. Certain taxpayers do not agree with staff and assert that the inclusion of advertising revenue as a gross receipt is a substantive change to the existing regulation."

If you have any questions, please do not hesitate to contact me.

Very truly yours,



Jeffrey M. Vesely

cc: Ms. Annie H. Huang

May 22, 2009

Ms. Carole Rouin
California Franchise Tax Board
Legal Division
P.O. Box 1720
Rancho Cordova, CA 95741-1720

Re: Proposed Amendments to California Reg. Sec. 25137-8

Dear Ms. Rouin:

Please find as Exhibit A California Regulation Section 25137-8 ("Regulation") with the amendments proposed by the Franchise Tax Board (FTB). On behalf of Comcast, we have also included additional proposed changes, as highlighted, to clarify that the FTB amendments to the Regulation were not intended to include cable television services.

If you have any questions regarding the proposed changes please don't hesitate to call Tom Donnelly at Comcast at (215) 981-7557 or me at (202) 383-0936.

Best Regards,

Michele Borens

Exhibit A

Section 25137-8 is amended to read:

§ 25137-8. Motion Picture and Television Film Producers, Distributors, and Television Networks - Apportionment of Income.

(a) In General. When a business entity in the business of producing or distributing motion picture, film, or television programming, whether broadcast or telecast through the public airwaves, by cable, direct or indirect satellite transmission, or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated, or independent television broadcasting station has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this regulation. ~~This regulation does not apply to a business entity which earns receipts from the provision of cable television services.~~

(b) Definitions.

For purposes of this regulation ~~only~~, the following definitions shall apply.

(1) "Film" means the physical embodiment of a play, story, or other literary, commercial, educational, or artistic work, produced for telecast, as a motion picture, video tape, disc, or any other type of format or medium. A "film" is deemed to be tangible personal property. "Film" does not include video cassettes or discs sold for personal use.

(2) Each episode of a series of films produced for television shall constitute a separate film notwithstanding that the series relates to the same principal subject and is produced during one or more television seasons.

(3) A "producer" is a business entity which develops and creates motion picture, television, or web-based content.

(4) A "distributor" is a business entity which, upon completion of production, exhibits motion picture, film, television, or web-based programs, and develops and implements the marketing campaign, including but not limited to advertising. A distributor does not include theaters or other business entities, to the extent they provide ~~cable or~~ satellite transmission services.

(5) "Release date" means the date on which a film is placed in service. A film is placed in service when it is first telecast or exhibited to the primary audience for which the film was created. Thus, a motion picture theater film is placed in service when it is first publicly exhibited for entertainment purposes and an educational film is placed in service when it is first exhibited for instructional purposes. Each episode of a television series is placed in service when it is first telecast. A film is not placed in service merely because it

is completed and therefore in a condition or state of readiness and availability for telecast or exhibition, or merely because it is telecast or exhibited to prospective exhibitors, sponsors, or purchasers, or it is shown in a "sneak preview" before a select audience.

(6) "Rent" shall include license fees for the exhibition or telecast of films.

(7) "Tangible personal property" used in the business, whether owned or rented, shall include but is not limited to sets, props, wardrobes, and other similar equipment.

(8) A "subscriber" to a subscription television telecaster is the individual residence or other outlet which is the ultimate recipient of the transmission.

(9) "Telecast" means the transmission of an electronic signal or other signal by radiowaves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers or subscribers, or by any other means of communication.

(10) "Advertising revenue" includes advertising from all sources, including but not limited to online advertisements, embedded advertisements, product placement, barter transactions, and the sale of air time used for advertising purposes.

(11) "Cable television services" means the transmission to customers or subscribers of video programming, or other programming service over a cable system directly or indirectly owned or controlled by the business entity or any unitary affiliate of the business entity.

(c) Apportionment of Business Income. The property, payroll, and sales factor of the apportionment formula for motion picture and television film producers, distributors and television networks shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation.

(1) Property Factor.

(A) In General.

(i) In the case of rented studios, the net annual rental rate shall include only the amount of the basic or flat rental charge by the studio for the use of a stage and other permanent equipment such as sound recording equipment rented from other sources or from the studio not covered in the basic or flat rental charge and used for one week or longer (even though rented on a day-to-day basis) shall be included. Lump-sum net rental payments for a period which encompasses more than a single income year shall be assigned ratably over the rental period.

(ii) The value of the films shall:

(I) be the original cost of producing the film as determined for federal income tax purposes, before any adjustment for federal credits which have not been claimed for state purposes, and

(II) include talent salaries.

(iii) The value of a film shall not be included in the property factor until its release date.

(iv) Video cassettes and discs shall be included in the property factor at their inventory cost as shown in the taxpayer's books and records.

(B) Denominator.

(i) All real property and tangible property (other than films) whether owned or rented, which is used in the business, shall be included in the denominator.

(ii) Films, other than films the cost of which is expensed for California tax purpose at the time of production, shall be included in the property factor at original cost for twelve years beginning with the release date.

(iii) Films of a topical nature including news or current event programs, sporting events or interview shows, the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for one year beginning with the release date.

(iv) All other films, other than those included in the denominator under clause (ii) or (iii) of this subparagraph, shall be aggregated and treated as a single film property which shall be included in the property factor. Such property shall be valued at eight times the gross receipts generated during the income year from the theater distribution, network television, television syndication, cable or satellite television, subscription and the marketing of video cassettes and discs through licensing or direct selling, or similar receipts, but in no event in an amount greater than the total original cost of such aggregated film property.

(C) Numerator.

(i) If tangible personal property (other than films) is located or used in this state for part of the income year, its value shall be determined by applying the ratio which the number of days the property is located or used in this state bears to the total number of days such property was owned or rented during the income year.

(ii) The total value of films that are included in the property factor under subparagraph (B) of paragraph (1) of this subsection shall be attributed to this state in the same ratio in which the total California receipts from such films as determined in subparagraphs (A), (B), and (C) of paragraph (3) of this subsection pertaining to the sales factor bears to the total of such receipts everywhere.

(2) Payroll Factor.

(A) In General.

(i) The denominator shall include all compensation paid to employees during the income years, including talent salaries. Residual and profit participation payments constitute compensation paid to employees.

(ii) The amount paid to a corporation for providing the services of an actor or director who is an employee of such corporation or for loaning the services of an actor or director who is under contract with such corporation shall, if substantial, be included in the producer's payroll factor as if the amount paid was compensation paid to an employee of the producer.

(B) Numerator. Compensation of employees in the production of a film on location shall be attributed to the state where the services are or were performed. Compensation of all other employees shall be governed by Regulations 25132 and 25133.

(3) Sales Factor.

(A) The numerator shall include all gross receipts derived by the taxpayer from sources within this state including, but not limited to, the following:

(i) Gross receipts, including advertising revenue, from films in release to theaters and television stations located in this state.

(ii) Gross receipts, including advertising revenue, from films in release to or by a television network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the *Television & Cable Factbook*, Vol. I, "Stations Volume," Television Digest, Inc., Washington, D.C., if available, or by other published market surveys, or if none is available, by population data published by the U.S. Bureau of Census provided that the source selected is consistently used from year to year for that purpose.

(iii) Gross receipts, including advertising revenue, from films in release to subscription television telecasters shall be attributed to this state in the ratio that the subscribers for such telecaster location in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in *Cable Vision*, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the U.S. Bureau of the

Census for all states in which the telecaster has subscribers, provided that the source selected is consistently used from year to year for that purpose.

(iv) Receipts from sales and rentals, licensing or other disposition of video cassettes and discs or any other format or medium intended for personal use shall be included in the numerator of the sales factor as provided in Regulations 25135 and 25136.

(d) This regulation applies to taxable years beginning on and after January 1, 2010 [or January 1 of the tax year of the adoption of the regulatory changes.]

Note: Authority cited: Section 2642219503, Revenue and Taxation Code.

Reference: Section 25137, Revenue and Taxation Code.

From: Eric Miethke [EMiethke@nmgovlaw.com]
Sent: Friday, May 15, 2009 9:38 AM
To: Rouin.Carole
Subject: Tweaking of "distributor"

A "distributor is a business entity which, upon completion of production licenses a film for exhibition by a related or unrelated third party. The distributor also usually, though not always, develops and funds the campaign to market the film. A theatre which exhibits the film is not a distributor. A producer may also be a distributor if it licenses its own films or those of others for exhibition



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VIA ELECTRONIC MAIL

September 22, 2011

Colleen Berwick
Franchise Tax Board
Legal Branch
P.O. Box 1720
Rancho Cordova, CA 95741-1720

Re: Proposed Regulation Sections 25137-8, 25137-8.1, 25137-8.2

Dear Ms. Berwick:

This letter is presented on behalf of Pillsbury Winthrop Shaw Pittman LLP with respect to Proposed Regulation Sections 25137-8, 25137-8.1 and 25137-8.2. These written comments confirm the oral comments I made at the hearing on September 13, 2011.

1. Applicable Dates

In both proposed Regulation 25137-8.1 and 25137-8.2, a January 1, 2010 applicable date is being proposed. As noted at the hearing, we would submit that said date would be contrary to Revenue and Taxation Code ("RTC") Section 19503. In addition, it would be contrary to the directions of the three-member Franchise Tax Board and the Initial Statement of Reasons.

RTC § 19503(b)(1) provides:

Except as otherwise provided in this subdivision, no regulation relating to Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), or this part shall apply to any taxable year ending before the date on which any notice substantially describing the expected contents of any regulation is issued to the public.

While RTC § 19503(b)(2) provides a list of exceptions to the foregoing, none are relevant in this matter.

Further, as noted in the Initial Statement of Reasons, in accordance with directions of the three-member Board, the proposed amendments to Regulation 25137-8 are to be “effective for future years.” The Initial Statement of Reasons provides:

As originally presented to the Franchise Tax Board, staff proposed to amend the current regulation. Members of the Franchise Tax Board expressed concerns that amendment of the current regulation might be construed as retroactively addressing issues that were interpreted differently by staff and some members of the effected taxpayers. To address that concern staff has modified the proposed action to 1) make no changes to the current regulation other than to renumber it and limit its effective date and 2) propose the adoption of a new regulation reflecting the changes proposed to be made to the current regulation by staff and have the new regulation be effective with respect to future years. (Emphasis added.)

In this matter, the formal notice of proposed Regulation 25137-8, 25137-8.1 and 25137-8.2, was issued to the public in August 2011. As such, in accordance with RTC § 19503, the following revisions should be made to proposed Regulation 25137-8.1 and 25137-8.2.

- a. For proposed Regulation 25137-8.1(a), the last sentence should be revised to read:

This regulation applies to taxable years beginning on or after January 1, 1982, and before January 1, 2012.

- b. Proposed Regulation 25137-8.2(d) should be revised to read:

This regulation applies to taxable years beginning on or after January 1, 2012.

2. News and Sports

In the Initial Statement of Reasons at page 1, it is provided:

Changes are made to the current regulation which excluded news and sports filmed for telecast from the definition of films to now included [sic] them in the definition of films. This means news and sports filmed for telecast will

now be included in the calculation of the property factor as films. This change conforms California's treatment to the provision of the Multistate Tax Commission Regulation IV.18(h).

We would submit that the following sentence should be inserted between the second and third sentences to make it clear that this change also affects the calculation of the sales factor:

In addition, revenues from news and sports will now be included in the calculation of the sales factor under paragraph (c)(3)(A).

If you have any questions, please do not hesitate to contact me.

Very truly yours,

A handwritten signature in black ink, appearing to read "Jeffrey M. Vesely", with a long horizontal flourish extending to the right.

Jeffrey M. Vesely

cc: Benjamin F. Miller
Annie H. Huang



Pillsbury Winthrop Shaw Pittman LLP
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Jeffrey M. Vesely
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November 11, 2011

VIA ELECTRONIC MAIL

Colleen Berwick
Franchise Tax Board
Legal Branch
P.O. Box 1720
Rancho Cordova, CA 95741-1720

Re: Proposed Regulation Sections 25137-8, 25137-8.1 and 25137-8.2

Dear Ms. Berwick:

This letter is presented on behalf of Pillsbury Winthrop Shaw Pittman LLP with respect to Proposed Regulation Sections 25137-8, 25137-8.1 and 25137-8.2. These comments are in response to the Notice of Modifications to Text of Proposed Regulation Section 25137-8.2 and the Franchise Tax Board ("FTB") Staff Summary of Comments Received, Responses and Recommendations Proposed Adoption of Regulations 25137-8 and 25137-8.2. Further, these comments should be read in conjunction with our letter dated September 22, 2011 ("September 22 letter") in this matter and be considered a supplement thereto.

Applicable Dates

As noted in our September 22 letter, in accordance with Revenue and Taxation Code ("RTC") section 19503, the applicable dates for proposed Regulations 25137-8.1 and 25137-8.2 should be revised as follows:

- a. For proposed Regulation 25137-8.1(a), the last sentence should be revised to read:

This regulation applies to taxable years beginning on or after January 1, 1982, and before January 1, 2012.

- b. Proposed Regulation 25137-8.2(d) should be revised to read:

This regulation applies to taxable years beginning on or after
January 1, 2012.

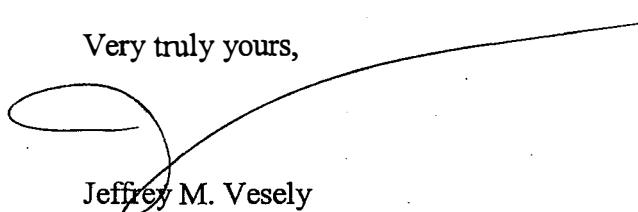
The FTB Staff's response to our prior comments is that the proposed amendments to Regulation 25137-8 relate to RTC § 25137 which was enacted in 1966. Staff relies on RTC § 19503(c) and contends that the limitations of RTC § 19503(b) do not apply since RTC § 25137 was enacted before January 1, 1998. Staff is not correct for a number of reasons.

1. In 1997, Assembly Bill No. 713 was enacted to conform California law to amendments to the federal Taxpayers' Bill of Rights. RTC § 19503 was part of AB 713 and was amended to conform to Internal Revenue Code § 7805 which, in turn, was intended to provide relief from retroactive applications of regulations. See Senate Rules Committee Analysis of AB 713, pages See Senate Rules Committee Analysis of AB 713, pages 5-6 (copy enclosed).
2. Regulation 25137-8 is a special industry regulation which is more akin to a legislative regulation than an interpretative regulation. Indeed, nowhere in RTC § 25137 is there any mention of any special industry, much less the motion picture industry. As such, any changes to Regulation 25137-8 should be applied prospectively and not retroactively.
3. There are significant changes being made to Regulation 25137-8 in proposed Regulation 25137-8.2. This is not a mere clarification of existing law. Accordingly, these changes should be applied prospectively.
4. Finally, as noted in our September 22 letter (page 2), the three-member FTB directed Staff to the effect that the proposed amendments to Regulation 25137-8 were to be "effective for future years." Since the formal notice of proposed Regulations 25137-8, 25137-8.1 and 25137-8.2 was not issued to the public until August 2011, the January 1, 2012 effective (applicable) date would be in accord with RTC § 19503.

Colleen Berwick
November 11, 2011
Page 3

If you have any questions, please do not hesitate to contact me.

Very truly yours,



Jeffrey M. Vesely

Enclosure

cc: Benjamin F. Miller (w/enc.)
Annie H. Huang (w/enc.)

SENATE RULES COMMITTEE

AB 713

Office of Senate Floor Analyses

1020 N Street, Suite 524

(916) 445-6614

Fax: (916) 327-4478

THIRD READING

Bill No: AB 713

Author: Caldera (D)

Amended: 6/11/97 in Senate

Vote: 21

SENATE REVENUE & TAXATION COMMITTEE : 7-0, 6/18/97

AYES: Alpert, Burton, Hurtt, Karnette, Knight, Kopp, Lee

NOT VOTING: Greene, McPherson

SENATE APPROPRIATIONS COMMITTEE : 11-0, 9/4/97

AYES: Johnston, Alpert, Burton, Calderon, Karnette,

Kelley, Lee, Leslie, McPherson, Mountjoy, Vasconcellos

NOT VOTING: Dills, Johnson

ASSEMBLY FLOOR : 78-0, 5/27/97

SUBJECT : Taxpayers' rights: conformity

SOURCE : Franchise Tax Board

DIGEST : This bill conforms state law to recent amendments to the federal Taxpayers' Bill of Rights by revising provisions of California's Katz-Harris Taxpayer Bill of Rights (TBR) and the Personal Income Tax and Bank and Corporation Tax Laws. Specifically, this bill, among other things, expands notice requirements, extends the time for making tax payments without penalty, allows for abatement of interest under certain circumstances, restricts retroactive application of regulations, and reimburses taxpayer's litigation costs for claims the FTB cannot substantiate.

ANALYSIS :

Joint Return Filed after Separate Return

Existing law:

As set forth in Internal Revenue Code (IRC) section 402, provides that taxpayers who file separate returns for tax years beginning after July 30, 1996 are no longer precluded from filing a joint tax return for that same year even though they cannot pay the tax reflected on the joint return.

Precludes California taxpayers, who for federal purposes file a separate return and for the same year file an amended return changing their filing status to a joint return, from filing a California joint return unless all previous separate personal income tax liabilities are paid.

Under state law, in general, the filing status used under federal law must be used under state law.

This bill:

Would allow taxpayers who file a separate federal return for taxable years beginning on or after January 1, 1997, and then switch to a joint return for the same year, to use the same filing status for state purposes even though previous, separate liabilities of either taxpayer have not been paid.

Phone number of Person Providing Information Returns

Existing law:

In California, requires third-parties, who are reporting taxable information for a taxpayer, (through a 1099 form, for example), to send a copy of the federal information return providing this information to the taxpayer and the FTB. Federal law requires the third party to provide its name and address. Section 1201 of the FTBR 2 added the requirement that the third-party provide their telephone number on information returns required to be filed after December 31, 1996.

This bill:

Would require third-parties currently required to include their name and address on California-only information returns provided to the taxpayer and the FTB, would also

have to include their telephone number for information returns required to be filed after January 1, 1999. For those third-parties filing a copy of the federal information return, the telephone number already would be included under the FTBR2.

Termination of Installment Payment Agreements

Existing state law:

Provides that before an installment payment agreement for delinquent taxes can be considered, all delinquent returns must be filed. If a taxpayer fails to make an installment payment on time or fails to file and fully pay all subsequent returns, the FTB sends the taxpayer a notice of default indicating that the agreement is null and void. The taxpayer has between 10 and 20 days to show that the default was due to a reasonable cause.

Existing federal law:

Provides that unless the IRS has determined that collection of an installment agreement is in jeopardy, the IRS is required to provide the taxpayer with a notice of and reason for termination, alteration, or modification of an installment agreement for any reason, including the taxpayer's failure to make timely installment payments or pay any other tax liability when due. Prior to the FTBR 2, notice was only provided for termination.

Requires the Secretary of the Treasury to establish procedures for an independent departmental review of agreements terminated by the IRS, if such review is requested by the Taxpayer. The review process does not stay collection.

This bill:

Would conform California's laws on termination of installment agreements to the procedures adopted in the FTBR2, including expanding the time for notice to 30 days. If the taxpayer and FTB mutually agree to a change in the installment agreement, notice would not be required.

Would establish an independent state review process with procedures established by the Taxpayers' Advocate if such review is requested by the Taxpayer. The review process would not stay collection.

Extension of Interest-Free Period and Time to Pay

Existing law:

Provides that California taxpayers have 10 calendar days after notice and demand to pay amounts due without accruing

additional interest. For court-ordered debts and Department of Industrial Relations' delinquencies collected by the FTB, if the debts accrue interest at the rate provided under the Personal Income Tax (PIT) & Bank & Corporation Tax (BCT) law, the 10-day rule is applied. In addition, (1) deficiency assessments are due and payable 10 calendar days after notice and demand for payment, and (2) underpayment penalties are imposed if the amount required to be shown on the return is not paid within 10 calendar days after notice and demand for payment.

As set forth in section 303 of the FTBR 2, provides federal taxpayers (a) eleven additional calendar days (21 calendar days instead of the 10 calendar days previously allowed) on amounts due and owing the IRS of \$100,000 or less and (b) ten business days (instead of the 10 calendar days previously allowed) on amounts of \$100,000 or more.

This bill:

Would give California taxpayers five additional calendar days to pay amounts due and owing the FTB, including court-ordered debts and Department of Industrial Relations' delinquencies referred to the FTB for collection, (a) without accruing additional interest, (b) before deficiency assessments would be considered delinquent, or (c) before penalties can be imposed for underpayment of taxes.

Existing law:

Authorizes the FTB to issue subpoenas to third-parties, including recordkeepers, to obtain taxpayer information.

As set forth in Section 1001 of the FTBR 2, authorizes the IRS to use summonses to obtain taxpayer information from third-party recordkeepers, which is defined to include enrolled agents, attorneys, and accountants.

This bill:

Would conform California's definition of "third-party recordkeeper" for purposes of issuing subpoenas to the federal definition, which specifically includes enrolled

agents.

Abatement of Interest due to errors or delays

Existing law:

Allows the FTB to abate interest attributable to errors or delays caused by an officer or employee performing a ministerial act. Requests for the abatement of interest due to ministerial acts are submitted to an internally established interest abatement team that determines whether the abatement of interest is appropriate. Federal regulations and rulings are used to define "ministerial act". The Board of Equalization (BOE) has jurisdiction over adverse determinations by the FTB with respect to tax assessments and related interest and penalties, but not abatements of interest due to ministerial acts.

This bill:

Would give the BOE jurisdiction over adverse determinations by the FTB with respect to abatements of interest due to ministerial or managerial acts. The taxpayer would have 180 days after it is mailed notice of FTB's adverse action to appeal to the BOE.

Relief from Retroactive Application of Regulations

Existing state law:

Provides that an FTB regulation applies retroactively only if FTB issues the regulation within 24 months of the date of enactment of the underlying law, or within 24 months of the date of publication of a federal temporary or final regulation of which California conforms to the underlying law.

As set forth in the Administrative Procedures Act (APA), governs the FTB's regulation process and requires the FTB to provide notice to the public of its intent to issue a regulation and provide a public hearing. When a regulation is approved, it is filed with the Secretary of State and is effective 30 days thereafter. Regulations, as well as rulings, are applied retroactively unless FTB prescribes otherwise.

Existing federal law:

As set forth in the FTBR 2, allows IRS rulings and regulations to apply retroactively only: (a) if issued within 18 months of the date of the enactment of the underlying law; (b) to prevent abuse; (c) if it corrects a procedural defect in the issuance of prior regulations; (d) if it relates to the Treasury's internal practices or procedures; (e) if the legislature authorizes retroactivity; or (f) the taxpayer elects retroactive application. Otherwise, the regulation is applicable on the earlier of: (a) the date the regulation is filed with the Federal Register, (b) in the case of a final regulation, the date the proposed or temporary regulation was filed with the Federal Register, or (c) the date notice substantially describing the expected contents of any temporary, proposed or final regulation is issued to the public.

This bill:

Would conform California's regulation process to that set forth in the FTBR 2. However, FTB would have 24 months after the enactment of the underlying California law to issue the regulation retroactively. In addition, for federal laws to which California conforms, FTB would have 24 months after the issuance of any federal final regulation with respect to that law to issue a California regulation with retroactive effect. Otherwise, the

federal regulation would apply on the date any notice substantially describing the expected contents issued to the public.

Existing federal law:

As set forth in the FTBR 2, when taxpayers petition the tax court to protest an adverse IRS action, the burden of establishing whether the IRS' position was substantially justified has been shifted from the taxpayer to the IRS. If the taxpayer has first exhausted all administrative remedies before going to tax court, the taxpayer is entitled to reimbursement of expenses, including reasonable attorneys fees at \$110 per hour. The IRS' position is presumed to be substantially justified if the IRS did not follow its applicable published guidelines. In determining whether the taxpayer has exhausted all administrative remedies, the taxpayer's failure to agree to an extension of the statute of limitations cannot be taken into consideration.

Existing state law:

Provides that taxpayers must exhaust all administrative remedies before being entitled to litigation expenses, and must establish that the FTB was not substantially justified

in its position.

This bill:

Would conform California law to the FTBR 2 relating to reimbursement of expenses for proceedings or BOE hearings beginning on or after January 1, 1998. However, there would not be a conforming increase in attorneys fees because current law does not limit these fees beyond what is "reasonable"; i.e., \$110 would probably be presumed reasonable.

Unauthorized Enticement of Information Disclosure

Existing state law:

Provides that taxpayers can bring an action for damages against the state if an employee or officer recklessly disregards board published procedures causing the taxpayer to be aggrieved.

Existing federal law:

As set forth in the FTBR 2, provides that taxpayers can bring an action for damages against the U.S. government, if IRS employees or officers were to intentionally entice taxpayers' representatives to give them taxpayer information by compromising the representative's tax. The amount of the award is limited to the lesser of actual, direct economic damages and costs or \$500,000.

This bill:

Would conform state tax law to the FTBR 2, enabling taxpayers to bring an action against the state for damages and costs not to exceed \$500,000 for actions brought after January 1, 1998, if the FTB's employees or officers intentionally enticed the taxpayer's representative to give the FTB employee/officer taxpayer information by settling or compromising the representative's tax.

Disclosure of Collection Information

Existing law:

Provides that tax return information is confidential and cannot be disclosed to anyone other than the taxpayer or the taxpayer's representative unless disclosure is specifically authorized by law.

This bill:

Would conform state tax law to the FTBR 2 which authorizes disclosure of collection activity, if a couple files a joint return for which an amount is due and the taxpayers are no longer married or living in the same household. Either taxpayer can request in writing, and the IRS/FTB shall disclose to that person, whether the IRS has attempted to collect delinquency from the other taxpayer, the general nature of the collection activities and the amount collected.

Shift of Burden of Proof Re: Disputes

Existing state law:

Provides that if a taxpayer asserts a reasonable dispute as to the amount of information provided by a third-party that the FTB has determined to be correct, the burden is on the taxpayer to substantiate that the income item is not theirs; if the matter cannot be resolved, the taxpayer may file a protest and can ultimately appeal to the BOE.

Existing federal law:

As set forth in the FTBR2, provides that the burden of proof may shift to the IRS in a court proceeding in the case of deficiencies resulting from certain information returns, which are those that are less detailed. (The shift does not apply to third-party information returns, which are detailed and comprehensive, as follows, nor information FTB receives directly from the IRS: partnerships, limited liability companies, S corporations, Tax Shelter promoters or Charitable Trusts.)

This bill:

Would conform state tax law to the FTBR 2 by shifting the burden of proving correctness of items of income reported by third-parties on information returns filed with the FTB or wage information filed with EDD and used by FTB to the FTB if the taxpayer asserts a reasonable dispute of the amount assessed, appeals FTB's adverse action on his or her protest and has fully cooperated with the FTB within a reasonable period of time. The shift would not apply to the third-party information returns that it does not apply to at the federal level.

Required Notice for Unassociated Payments

Existing federal law:

Provides that if the IRS cannot associate a payment with a taxpayer's account, it must make a reasonable effort to provide the taxpayer notification of the IRS' inability within 60 days of receipt of the payment.

Existing state practice:

Provides that if a payment is received without a document related to the amount paid and the FTB cannot locate the

account for which the payment is made, the department makes a reasonable attempt to locate the taxpayer to determine the account number within 60 days from the date the payment is received.

This bill:

Would conform state law to the FTBR2 notification requirement for unassociated payments.

In 1988, Congress enacted a Taxpayers' Bill of Rights (TBR) for laws administered by the IRS. Using the federal TBR as a springboard, California enacted its own TBR for laws administered by the FTB, BOE and EDD. Those laws went into effect on January 1, 1989. On July 30, 1996, Congress enacted an IRS TBR 2 to provide for increased protections of taxpayers rights in complying with the Internal Revenue Code and in dealing with the IRS in its administration of the tax laws. This bill would give comparable rights to California taxpayers.

FISCAL EFFECT : Appropriation: No Fiscal Com.: Yes
Local: No

FTB had no specific information on the magnitude of the fiscal impact of these provisions. In the case of annually notifying taxpayers of deficiencies, these costs would increase over time. In addition, shifting the burden of proof on proving the accuracy of certain information is a substantial change in the responsibilities of FTB. This change, however, only applies to appeals and requires that the taxpayer cooperate with FTB within a reasonable period time. Consequently, the fiscal effect may not be as extensive as it might otherwise seem.

DOF, however, estimates that the cumulative cost of the bill's various provisions could eventually result in major increased cost to FTB, primarily in the provisions (1) shifting the burden of proof from the taxpayer to FTB in two types of situations, (2) increasing the amount of litigation costs reimbursable to taxpayers, and (3)

requiring that FTB annually notifying taxpayers if a deficiency exists.

SUPPORT : (Verified 9/4/97)

Franchise Tax Board (source)
Cal-Tax

OPPOSITION : (Verified 9/4/97)

Department of Finance

ARGUMENTS IN SUPPORT : The bill is intended to selectively conform with the federal Taxpayers' Bill of Rights 2 provisions. The provisions are intended to improve the fairness of the tax system and enhance the ability of taxpayers to deal successfully with the FTB.

ARGUMENTS IN OPPOSITION : The Department of Finance states this bill would result in unplanned, annual General Fund revenue losses of a minor amount, as well as potentially major increases in state administrative costs.

In addition, Finance is opposed to the provisions of this bill that would shift the burden of proof from the taxpayer to the FTB. This is counter to the basic premise of the income and franchise taxes as being based on self-assessment.

Requiring annual notices of delinquency to be sent to taxpayers does not appear to be cost-effective. FTB currently pursues these accounts until the probability of collection is low. Therefore, this provision may unnecessarily increase administrative costs.

_ DLW:jk 9/4/97 Senate Floor Analyses
SUPPORT/OPPOSITION: SEE ABOVE
**** END ****

Item #3c2-10.txt

STATE OF CALIFORNIA

FRANCHISE TAX BOARD

PUBLIC HEARING

FOR THE AMENDMENT OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8, AND THE
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8.2

TUESDAY, SEPTEMBER 13, 2011

FRANCHISE TAX BOARD
9646 BUTTERFIELD WAY
TOWN CENTER GOLDEN STATE ROOM A
SACRAMENTO, CALIFORNIA

1:00 P.M.

REPORTED BY:

SANDRA VON HAENEL
CSR NUMBER 11407

1 APPEARANCES

2

3 HEARING OFFICER:

4 Benjamin F. Miller

5

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7 FRANCHISE TAX BOARD STAFF:

8 Colleen Berwick

9

10 PUBLIC COMMENTS:

11 Eric J. Miethke - Nielsen Merksamer Parriello
Gross & Leoni

12 Jeffrey M. Vesely - Pillsbury Winthrop Shaw Pittman

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1 SACRAMENTO, CALIFORNIA

2 TUESDAY, SEPTEMBER 13, 2011, 1:00 P.M.

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4 HEARING OFFICER MILLER: Good afternoon everyone.

5 My name is Benjamin F. Miller. I'm counsel for
6 Multistate Tax Affairs with the Franchise Tax Board and will
7 be acting as hearing officer for the proposed amendments to
8 Regulation 25137-8 and proposed adoption of Regulation
9 25137-8.2 of Title 18 of California Code of Regulations.
10 These regulations deal with the apportionment of income for
11 the motion picture and television industry.

12 As required by the California Administrative
13 Procedures Act, a notice of this hearing, the proposed
14 language, and the initial statement of reasons supporting
15 the proposed language of these two regulations was published
16 on the Office of Administrative Law's register of proposed
17 rulemaking actions and mailed to members of the public as
18 provided for in Government Code Section 11346.4, on July 29,
19 2011.

20 In addition, the notice of proposed changes, the
21 initial statement of reasons, and changes to proposed
22 Regulation 25137-8.2 proposed by staff were posted on the
23 Franchise Tax Board website at www.ftb.ca.gov. All those
24 documents are on the table to my right.

25 This hearing is being held pursuant to Government Code

3

1 Section 11346.4 to allow members of the public to submit
2 statements and comments regarding the proposed changes to
3 current Regulation 25137-8 and the proposed adoption and
4 changes to Regulation 25137-8.2.

5 Anyone who desires to make an oral presentation at
6 this hearing will be given an opportunity to do so in a few
7 moments. In addition, anybody who desires to submit written
8 comments regarding these proposals may submit such comments
9 to Colleen Berwick or myself. Comments may be faxed to
10 (916)845-3648 or may be e-mailed to Ms. Berwick at
11 Colleen.Berwick@ftb.ca.gov or myself at Ben.Miller@ftb.ca.gov.

12 Oral comments received today as well as written
13 comments received since July 29th will be considered as part
14 of the formal regulatory process. All comments, oral and
15 written, will be considered by the Franchise Tax Board staff
16 and formally addressed in writing. Staff will prepare a
17 Summary of Comments, Responses, and Recommendations (the

18 Summary). The Summary will be published on the Franchise
19 Tax Board website and will be included in the rulemaking
20 files submitted to the Office of Administrative Law as
21 provided by the Administrative Procedures Act.

22 The three-member Franchise Tax Board will have the
23 opportunity to review the Summary. If any member of the
24 public requests, the three-member Franchise Tax Board will
25 consider at a meeting of the Board whether to adopt the

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1 proposals as presented at this hearing or as they may be
2 amended as a result of comments. The next meeting of the
3 Franchise Tax Board is scheduled for December 1st, 2011. It
4 would be our intention to present this to the Board at that
5 time regardless of whether there is a request to do so.

6 To my left is the court reporter who will take down
7 everything we say today. At the end of the hearing a
8 transcript will be prepared which will also become a part of
9 the rulemaking file. Because a formal record of the hearing
10 is being made, I would ask each of you who desires to make a
11 comment or ask a question to identify yourself, who you
12 represent or for whom you work. Please speak clearly so the
13 court reporters can accurately record your comments. I
14 would also ask that you come to the microphone to make your
15 comments.

16 There is a register to the right that will become part
17 of the record of this hearing. If you haven't done so, we
18 would ask that you sign in before you leave. It would be
19 appreciated if you would leave your business cards as well.
20 A copy of the Summary and any proposed changes will be
21 mailed to those who attended the hearing or submitted
22 comments.

23 Current Regulation 25137-8 was originally adopted
24 effective for income years beginning after January 1, 1982,
25 and was renumbered to its current form in February 1987.

5

1 The regulation was developed in conjunction with members of
2 the motion picture and television industries.

3 Staff became aware that there were areas that the
4 current regulation did not explicitly address, and scheduled
5 Interested Parties meetings to discuss possible changes to
6 the existing regulation. Interested Parties meetings were
7 held on January 8, 2008, and May 15, 2009. Summaries of
8 those meetings were prepared and will be made part of the
9 rulemaking file for these proposed actions.

10 As originally presented to the Franchise Tax Board on
11 June 16, 2009, staff proposed to amend the current
12 regulation. Members of the Franchise Tax Board expressed
13 concerns that amendment of the current regulation might be
14 construed as retroactively addressing issues that were being
15 interpreted differently by staff and some affected
16 taxpayers.

17 To address that concern, staff has modified the
18 proposed action to, one, make no changes to the current
19 regulation other than to renumber it as Regulation
20 25137-8.1, and limit its effective date for taxable years
21 beginning before January 1, 2010; and, two, propose the
22 adoption of a new regulation reflecting the changes proposed
23 to be made to the current regulation by staff and have the
24 new regulation be effective with respect to taxable years
25 beginning on or after January 1, 2011.

6

1 The adoption of proposed Regulation Section 25137-8.2
2 is made to address the treatment of advertising revenue

3 generated by film properties. Current Regulation 25137-8
4 does not specifically address the treatment of receipts from
5 advertising. The addition of language dealing with
6 advertising, however, reflects the current interpretation
7 and policy of the Franchise Tax Board with respect to such
8 receipts. Furthermore, the current treatment of advertising
9 receipts by the Franchise Tax Board staff is consistent with
10 Multistate Tax Commission Regulation IV. 18(h) for television
11 and radio broadcasters, with Regulation Section 25137-1.2
12 for the print media industry and with similar rules adopted
13 in at least one other state.

14 The Franchise Tax Board's interpretation of the
15 current regulation with respect to the treatment of
16 advertising is currently being challenged by several
17 taxpayers. An amendment to the current regulation to
18 reflect this policy is not being proposed so as not to
19 preclude taxpayers contesting the Franchise Tax Board policy
20 from pursuing their remedies. No inference should be drawn
21 from the fact that language addressing this issue is only
22 included in the proposed Regulation 25137-8.2 and is not
23 included in the proposed amendments to Regulation Section
24 25137-8.1.

25 Changes are made to the current Regulation Section

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1 25137-8 in proposed Regulation Section 25137-8.2 to add
2 "Distributors" to those taxpayers subject to the regulation.

3 Changes are also made to the current regulation which
4 excluded news and sports filmed for telecast from the
5 definition of films to now include them in the definition of
6 films. This means news and sports filmed for telecast will
7 now be included in the calculation of the property factor as

8 films. The change conforms California's treatment to the
9 provision of the Multistate Tax Commission Regulation
10 IV. 18(h)

11 Staff is proposing to amend proposed Regulation
12 25137-8.2 in the following areas. A copy of those
13 amendments is on the table.

14 One proposal is to reorder paragraph (b) to place
15 the definitions in alphabetical order, not to change the
16 definitions.

17 Two is to consolidate the definition of "films"
18 in paragraph (2) so there is just one definition for films.

19 And one is to add language in paragraph (c)(1)(A)
20 to provide greater clarity.

21 And another is to (c)(3) to create a new
22 (c)(3)(A) and re-denominate the current proposed (c)(3)(A)
23 as (c)(3)(B)

24 It's just my own personal preference, it's hard to
25 have a (3)(A) without having a (B) afterwards. So I just

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1 crafted the language so the regulation would have an (A) and
2 (B).

3 Staff believes these changes are non-substantive and
4 sufficiently related, and thus intends to publish them as
5 part of a 15-day notice.

6

7 There are three specific areas staff would welcome
8 public comments and suggestions:

9

10 The current regulation, which will
11 hereinafter be Regulation Section 25137-8.1,
12 is applicable to producers of commercials.

13 Producers of commercials were removed from

14 proposed Regulation 25137-8.2 so that the
15 proposed regulation would conform to
16 Regulation IV.18(h) of the Multistate Tax
17 Commission. Comments on whether this
18 elimination should be made are solicited.

19

20 The second proposed Regulation 25137-8.2
21 modifies the current regulation by adding a
22 sentence stating the ownership of movie
23 theaters does not make an entity a
24 distributor. The intent of this insertion was
25 to make it clear that ownership of movie

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1 theaters by itself did not make an entity a
2 distributor. Is the proposed language clear?

3

4 Third, should the proposed Regulation
5 25137-8.2 be modified to anticipate changes in
6 methods of distribution? Staff has prepared
7 language that attempts to address this
8 question.

9

10 Staff also believes that and with respect to any
11 changes made in response to these questions, which were
12 raised in the hearing notice and informative digest, are
13 sufficiently related, and thus intends to publish them as
14 part of a 15-day notice if they are acceptable.

15 So we are open for comments at this time.

16 If you would like to come to the podium, we'd
17 appreciate it.

18 MR. VESELY: Jeffrey M. Vesely from Pillsbury

19 Winthrop, Shaw, Pittman. We have just a few comments about
20 the proposed regulations.

21 One is the applicable date that has been used for
22 Regulation 25137-8.1, and that it is only applicable through
23 tax years ending prior to January 1, 2010.

24 We believe that given that the notice here for this
25 regulation was not issued until on or about August 1st of

10

1 this year, under Section 19503 of the Revenue and Taxation
2 Code, that would mean that the regulation actually should
3 not be applicable until -- the changes should be applicable
4 all the way through that date August 1, 2011. So tax years
5 ending on August 1, 2011.

6 And also that would then mean that the Regulation
7 25137-8.2 would be applicable on or after tax years ending
8 August 1 of 2011 or after.

9 I believe that none of the exceptions under 19503
10 would apply to make this retroactive. And, further, since
11 this is an issue of whether or not this is a clarification
12 of existing law or making changes, we would submit that it
13 is actually new changes and therefore should be prospective
14 only. And so I think that's probably the date that should
15 be used.

16 The second comment we have is, in the Statement of
17 Reasons, there is a reference to the news and sports issue
18 and only a reference to the property factor adjustment.

19 We would again submit that, because of the change in
20 definition, and this is under Regulation 25137-8.2, this
21 would also affect the receipts factor with respect to news
22 and sports activities, and that from that applicable date,
23 the appropriate one for the .2 regulation, that this would
24 now be included within the sales factor. So it would be

25 both property factor and sales factor adjustment.

11

1 That's all I have. Thank you.

2 HEARING OFFICER MILLER: Just to respond to
3 Mr. Vesely. We will take those under advisement. We'll
4 have to check 19503. But I believe that the staff itself
5 has adopted prior to the effective date of 19503 the
6 amendments to the regulation are retroactive unless
7 specifically provided otherwise by the Board.

8 It's been our practice in this area mostly to have
9 gone through an interested parties meeting process and
10 people have had notice of what we intend to do with respect
11 to the effective date, but that's a decision which we will
12 consider here at staff, and the Board may have a question
13 with respect to that.

14 We probably intended to make it effective on a
15 January 1st basis one way or the other, rather than pick a
16 mid-year basis.

17 With respect to the question of sports, I'll take a
18 look at it and see if we need to deal with the sales factor
19 as well.

20 Thanks for bringing that to our attention.

21 Do we have any other comments?

22 Hearing no other comments --

23 MR. MIETHKE: Eric Miethke from Nielsen Merksamer.

24 Shall I come up?

25 HEARING OFFICER MILLER: Sure.

12

1 MR. MIETHKE: Eric Miethke, Nielsen Merksamer in
2 Sacramento. I represent the Motion Picture Association.

3 The only comment we have is that some of the changes

4 that were discussed by Mr. Miller today are indeed changes
5 we had discussed previously. I haven't seen it reduced to
6 writing. If you could please submit it to me. I apologize
7 if we missed them.

8 But we'll submit them to our group, and if there is
9 any more comments we will have to put them as part of the
10 15-day process.

11 With regard to the changes that Mr. Vesely made,
12 again, this is something that's new. You know, we've taken
13 a position on the sports regulation based on the 2010 date.
14 This is new information to us, so we may have to caucus on
15 that.

16 So right now we have no position on what Mr. Vesely
17 has suggested.

18 HEARING OFFICER MILLER: Okay.

19 My intention is to leave the record open at least
20 until this Friday for written comments to be submitted.

21 So, Eric, if you have comments, if you could get
22 something back to us by the end of this week, that would be
23 great. If not, we can hold it open for a somewhat longer
24 than that period if necessary. Please advise us if you'd
25 like to do that.

13

1 Any other comments?

2 All right.

3 Thank you all very much for your attendance. We
4 appreciate your comments.

5 (Hearing adjourned at 1:17 p.m.)

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1 REPORTER'S CERTIFICATE

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STATE OF CALIFORNIA)
COUNTY OF SACRAMENTO) ss.

8 I, SANDRA VON HAENEL, certify that I was the
9 official Court Reporter for the proceedings named herein, and
10 that as such reporter, I reported in verbatim shorthand
11 writing the named proceedings;

12 That I thereafter caused my shorthand writing to
13 be reduced to typewriting, and the pages numbered 1 through
14 14, inclusive, constitute a complete, true, and correct

15 Item #3c2-10.txt
16 record of said proceedings:

17

18 IN WITNESS WHEREOF, I have subscribed this
19 certificate at Sacramento, California, on the 28th day of
20 September, 2011.

21

22

SANDRA VON HAENEL
CSR No. 11407

23

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Section 25137-8 is amended and renumbered to read:

§ 25137-8.1. Motion Picture and Television Film Producers and Television Networks – Apportionment of Income.

(a) This regulation applies to motion picture and television film producers, producers of television commercials, and to television networks. The provisions of this regulation shall also apply to independent television stations to the extent they are members of a chain of commonly owned stations all of which operate as network affiliates or all of which are unaffiliated with a network but which operate collectively in purchasing properties for telecast or in marketing air time, or which operate as a producer. This regulation applies to taxable years beginning on and after January 1, 1982, and before January 1, 2011.

(b) *Definitions.*

(1) "Film" means the physical embodiment of a play, story or other literary, commercial, educational or artistic work; as a motion picture, video tape, disc or other similar medium, except that it does not include news or sports films produced for telecast.

"Film" does not include video cassettes or discs intended for home viewing.

(2) Each episode of a series of films produced for television shall constitute a separate film notwithstanding that the series relates to the same principal subject and is produced during one or more television seasons.

(3) "Release date" means the date on which a film is placed in service. A film is placed in service when it is first telecast or exhibited to the primary audience for which the film was created. Thus, a motion picture theater film is placed in service when it is first publicly exhibited for entertainment purposes and an educational film is placed in service when it is first exhibited for instructional purposes. Each episode of a television series is placed in service when it is first telecast. A film is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for telecast or exhibition, or merely because it is telecast or exhibited to prospective exhibitors, sponsors, or purchasers, or it is shown in a "sneak preview" before a select audience.

(4) A "film" is deemed to be tangible personal property.

(5) "Rent" shall include license fees for the exhibition or telecast of films.

(6) "Tangible personal property" used in the business, whether owned or rented, shall include but is not limited to sets, props, wardrobes, and other similar equipment.

(7) A "subscriber" to a subscription television telecaster is the individual residence or other outlet that is the ultimate recipient of the transmission.

(8) "Telecast" means the transmission of an electronic signal by radiowaves or microwaves or by wires, lines, coaxial cables, wave guides or other tangible conduits of communication.

(c) *Apportionment of Business Income.*

The property, payroll and sales factor of the apportionment formula for Motion Picture and Television Film Producers and Television Networks shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulation adopted pursuant thereto, except as provided in this regulation.

(1) Property Factor.

(A) In General.

(i) In the case of rented studios, the net annual rental rate shall include only the amount of the basic or flat rental charge by the studio for the use of a stage and other permanent equipment such as sound recording equipment, etc., except that additional equipment rented from other sources or from the studio not covered in the basic or flat rental charge and used for one week or longer (even though rented on a day-to-day basis) shall be included. Lump-sum net rental payments for a period that encompasses more than a single income year shall be assigned ratably over the rental period.

(ii) The value of the films shall—

(I) be the original cost of producing the film as determined for federal income tax purposes, before any adjustment for federal credits which have not been claimed for state purposes, and

(II) include talent salaries.

(iii) The value of a film shall not be included in the property until its release date.

(iv) Video cassettes and discs shall be included in the property factor at their inventory cost as shown in the taxpayer's books and records.

(B) Denominator.

(i) All real property and tangible property (other than films) whether owned or rented, which is used in the business, shall be included in the denominator.

(ii) Films, other than films the cost of which is expensed for California tax purpose at the time of production, shall be included in the property factor at original cost for twelve years beginning with the release date.

(iii) Films of a topical nature including news or current event programs, sporting events or interview shows, the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for one year beginning with the release date.

(iv) All films, other than those included in the denominator under clause (ii) or (iii) of this subparagraph, shall be aggregated and treated as a single film property which shall be included in the property factor. Such property shall be valued at eight times the gross receipts generated during the income year from the theater distribution, network television, television syndication, cable television, subscription television and the marketing of video cassettes and discs through licensing or direct selling, or similar receipts, but in no event in an amount greater than the total original cost of such aggregated film property.

(C) Numerator.

(i) If tangible personal property (other than films) is located or used in this state for part of the income year, its value shall be determined by applying the ratio the number of days the property is located or used in this state bears to the total number of days such property was owned or rented during the income year.

(ii) The total value of films that are included in the property factor under subparagraph (B) of paragraph (1) of this subsection shall be attributed to this state in the same ratio in which the total California receipts from such films as determined in subparagraphs (A), (B) and (C) of paragraph (3) of this subsection pertaining to the sales factor bears to the total of such receipts everywhere.

(2) Payroll Factor.

(A) In General.

(i) The denominator shall include all compensation paid to employees during the income years, including talent salaries. Residual and profit participation payments constitute compensation paid to employees.

(ii) The amount paid to a corporation for providing the services of an actor or director who is an employee of such corporation or for loaning the services of an actor or director who is under contract with such corporation shall, if substantial, be included in the producer's payroll factor as if the amount paid was compensation paid to an employee of the producer.

- (B) Numerator. Compensation of employees in the production of a film on location shall be attributed to the state where the services are or were performed. Compensation of all other employees shall be governed by Regulations 25132 and 25133.
- (3) Sales Factor Numerator. The numerator shall include all gross receipts of the taxpayer from sources within this state including the following:
- (A) Gross receipts from films in release to theaters and television stations located in this state.
- (B) Gross receipts from films in release to or by a television network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the *Television & Cable Factbook*, Vol. I, "Stations Volume," Television Digest, Inc., Washington, D.C., if available, or by other published market surveys, or, if none is available, by population data published by the U.S. Bureau of the Census.
- (C) Gross receipts from films in release to subscription television telecasters shall be attributed to this state in the ratio that the subscribers for such telecaster located in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in *Cable Vision*, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the U.S. Bureau of the Census for all states in which the telecaster has subscribers.
- (D) Receipts from sales and rentals of video cassettes and discs shall be included in the sales factor as provided in Regulations 25135 and 25136.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 25137, Revenue and Taxation Code.

Section 25137-8.2 is adopted to read:

§ 25137-8.2. Motion Picture and Television Film Producers, Distributors, and Television Networks - Apportionment of Income.

(a) In General. When a business entity in the business of producing or distributing motion picture, film, or television programming, or television commercials, whether broadcast or telecast through the public airwaves, by cable, direct or indirect satellite transmission, or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated, or independent television broadcasting station has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this regulation. This regulation does not apply to a business entity which earns receipts from the provision of cable television services.

(b) Definitions.

For purposes of this regulation only, the following definitions shall apply.

- (1) "Advertising revenue" includes advertising from all sources, including but not limited to online advertisements, embedded advertisements, product placement, barter transactions, and the sale of air time used for advertising purposes.
- (2) "Cable television services" means the transmission to subscribers of video programming or other programming service over a cable system.
- (3) A "distributor" is a business entity which, upon completion of production, licenses a film for exhibition by a related or unrelated third party. The distributor may also develop and fund the campaign to market the film. A theatre which exhibits the film is not a distributor based upon that fact. A producer may also be a distributor if it licenses its own films or those of others for exhibition.
- (4) "Film" means the physical embodiment of a play, story, or other literary, commercial, educational, or artistic work, produced for telecast, as a motion picture, video tape, disc, or any other type of format or medium.
 - (A) A "film" is deemed to be tangible personal property.
 - (B) "Film" does not include video cassettes or discs sold for personal use.
 - (C) Each episode of a series of films produced for television shall constitute a separate film notwithstanding that the series relates to the same principal subject and is produced during one or more television seasons.
- (5) A "producer" is a business entity which develops and creates motion picture, television, or web-based content.

(6) "Release date" means the date on which a film is placed in service. A film is placed in service when it is first telecast or exhibited to the primary audience for which the film was created. Thus, a motion picture theater film is placed in service when it is first publicly exhibited for entertainment purposes and an educational film is placed in service when it is first exhibited for instructional purposes. Each episode of a television series is placed in service when it is first telecast. A film is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for telecast or exhibition, or merely because it is telecast or exhibited to prospective exhibitors, sponsors, or purchasers, or it is shown in a "sneak preview" before a select audience.

(7) "Rent" shall include license fees for the exhibition or telecast of films.

(8) A "subscriber" to a subscription television telecaster is the individual residence or other outlet which is the ultimate recipient of the transmission.

(9) "Tangible personal property" used in the business, whether owned or rented, shall include but is not limited to sets, props, wardrobes, and other similar equipment.

(10) "Telecast" means the transmission of an electronic signal or other signal by radiowaves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers or subscribers, or by any other means of communication.

(c) Apportionment of Business Income. The property, payroll, and sales factor of the apportionment formula for motion picture and television film producers, distributors and television networks shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation. Income from new technologies, including but not limited to video streaming and online websites, to the extent they are utilized by motion picture and television film producers, producers of television commercials and to television networks to produce business income, shall be treated in a manner consistent with this regulation.

(1) Property Factor.

(A) In General.

(i) In the case of rented studios, the net annual rental rate shall include only the amount of the basic or flat rental charge by the studio for the use of a stage and other permanent equipment. Other equipment such as sound recording equipment rented from other sources or from the studio that is not covered in the basic or flat rental charge and used for one week or longer (even though rented on a day-to-day basis) shall be included. Lump-sum net rental payments for a period which encompasses more than a single income year shall be assigned ratably over the rental period.

(ii) The value of the films shall:

(I) be the original cost of producing the film as determined for federal income tax purposes, before any adjustment for federal credits which have not been claimed for state purposes, and

(II) include talent salaries.

(iii) The value of a film shall not be included in the property factor until its release date.

(iv) Video cassettes and discs shall be included in the property factor at their inventory cost as shown in the taxpayer's books and records.

(B) Denominator.

(i) All real property and tangible property (other than films) whether owned or rented, which is used in the business, shall be included in the denominator.

(ii) Films, other than films the cost of which is expensed for California tax purpose at the time of production, shall be included in the property factor at original cost for twelve years beginning with the release date.

(iii) Films of a topical nature including news or current event programs, sporting events or interview shows, the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for one year beginning with the release date.

(iv) All other films, other than those included in the denominator under clause (ii) or (iii) of this subparagraph, shall be aggregated and treated as a single film property which shall be included in the property factor. Such property shall be valued at eight times the gross receipts generated during the income year from the theater distribution, network television, television syndication, cable or satellite television, subscription and the marketing of video cassettes and discs through licensing or direct selling, or similar receipts, but in no event in an amount greater than the total original cost of such aggregated film property.

(C) Numerator.

(i) If tangible property (other than films) is located or used in this state for part of the income year, its value shall be determined by applying the ratio which the number of days the property is located or used in this state bears to the total number of days such property was owned or rented during the income year.

(ii) The total value of films that are included in the property factor under subparagraph (B) of paragraph (1) of this subsection shall be attributed to this state in the same ratio which the total receipts from such films as determined in subparagraphs (A), (B), and (C) of paragraph (3) of this subsection pertaining to the sales factor bears to the total of such receipts everywhere.

(2) Payroll Factor.

(A) In General.

(i) The denominator shall include all compensation paid to employees during the income years, including talent salaries. Residual and profit participation payments constituting compensation paid to employees.

(ii) The amount paid to a corporation for providing the services of an actor or director who is an employee of such corporation or for loaning the services of an actor or director who is under contract with such corporation shall, if substantial, be included in the producer's payroll factor as if the amount was paid was compensation paid to an employee of the producer.

(B) Numerator. Compensation of employees in the production of a film on location shall be attributed to the state where the services are or were performed. Compensation of all other employees shall be governed by Regulations 25132 and 25133.

(3) Sales Factor.

(A) The numerator shall include all gross receipts derived by the taxpayer from sources within this state including, but not limited to, the following:

(i) Gross receipts, including advertising revenue, from films in release to theaters and television stations located in this state.

(ii) Gross receipts, including advertising revenue, from films in release to or by a television network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the *Television & Cable Factbook*, Vol. I, "Stations Volume," Television Digest, Inc., Washington, D.C., if available, or by other published market surveys, or if none is available, by population data published by the U.S. Bureau of Census provided that the source selected is consistently used from year to year for that purpose.

(iii) Gross receipts, including advertising revenue, from films in release to subscription television telecasters shall be attributed to this state in the

ratio that the subscribers for such telecaster location in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in *Cable Vision*, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the U.S. Bureau of the Census for all states in which the telecaster has subscribers, provided that the source selected is consistently used from year to year for that purpose.

(iv) Receipts from sales and rentals, licensing or other disposition of video cassettes and discs or any other format or medium intended for personal use shall be included in the numerator of the sales factor as provided in Regulations 25135 and 25136.

(d) This regulation applies to taxable years beginning on and after January 1, 2011.

Note: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Section 25137, Revenue and Taxation Code.